

OPEN MEETING ITEM



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ORIGINAL



COMMISSIONERS
JEFF HATCH-MILLER - Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

EXECUTIVE DIRECTOR

22

ARIZONA CORPORATION COMMISSION

DATE: April 26, 2006

DOCKET NOS.: W-01583A-04-0178, W-01583A-05-0326 and W-01583A-05-0340
TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

LAS QUINTAS SERENAS WATER COMPANY

(RATES/FINANCING/ACRM)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

MAY 5, 2006

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

TO BE DETERMINED

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For more information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

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BRIAN C. McNEIL
EXECUTIVE DIRECTOR

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 JEFF HATCH-MILLER, Chairman
4 WILLIAM A. MUNDELL
5 MARC SPITZER
6 MIKE GLEASON
7 KRISTIN K. MAYES

8 IN THE MATTER OF THE APPLICATION OF
9 LAS QUINTAS SERENAS WATER CO. FOR A
10 RATE INCREASE.

DOCKET NO. W-01583A-04-0178

11 IN THE MATTER OF THE APPLICATION OF
12 LAS QUINTAS SERENAS WATER CO. FOR
13 AUTHORITY TO INCUR LONG-TERM
14 INDEBTEDNESS TO FINANCE WATER
15 SYSTEM IMPROVEMENTS AND ASSURE
16 COMPLIANCE WITH NEW ARSENIC RULES.

DOCKET NO. W-01583A-05-0326

17 IN THE MATTER OF THE APPLICATION OF
18 LAS QUINTAS SERENAS WATER CO. FOR AN
19 OPINION AND ORDER TO (i) RE-OPEN THE
20 RECORD IN A RECENT RATE CASE SO AS TO
21 CONSIDER EVIDENCE IN SUPPORT OF AN
22 ARSENIC COST RECOVERY MECHANISM,
23 AND (ii) MODIFY RATE CASE DECISION IN
24 ORDER TO ADD AN ARSENIC COST
25 RECOVERY MECHANISM AS AN
26 AUTHORIZED RATE AND CHARGE.

DOCKET NO. W-01583A-05-0340

27 DECISION NO. _____

28 **OPINION AND ORDER**

DATE OF HEARING:

March 1, 2006

PLACE OF HEARING:

Tucson, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

APPEARANCES:

Mr. Lawrence V. Robertson, on behalf of
Las Quintas Serenas Water Company;

Mr. John S. Gay, Intervenor, in propria
persona; and

Mr. Jason Gellman, Staff Attorney Legal
Division, on behalf of Commission
Utilities Division.

1 **BY THE COMMISSION:**

2 * * * * *

3 Having considered the entire record herein and being fully advised in the premises, the
 4 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

5 **FINDINGS OF FACT**

6 1. Las Quintas Serenas Water Company ("LQS" or "Company") provides water utility
 7 service to approximately 826 customers and an additional approximate 146 standpipe customers in
 8 an area around Sahuarita, Arizona.

9 2. Rules established by the United States Environmental Protection Agency ("EPA")
 10 require that the Maximum Contaminant Level ("MCL") for arsenic in potable water be reduced from
 11 50 parts per billion ("ppb") to 10 ppb, effective January 23, 2006.

12 3. Recent tests of LQS's water supply indicate that all three of its wells are producing
 13 water that exceeds the EPA MCL for arsenic. Well No. 7 shows an arsenic level of 12 ppb; Well
 14 No. 6 has an arsenic concentration of 15 ppb; and Well No. 5 has an arsenic concentration of 10.4
 15 ppb. (Ex. A-1 at 8).

16 4. On May 2, 2005, and May 12, 2005, LQS filed four inter-related documents with the
 17 Commission:

18 (a) A financing application to incur up to \$1,789,375¹ in long-term debt in order to
 19 make capital improvements to address the new arsenic standards and other water system
 20 improvements (Docket No. W-01583A-05-0326)("Finance Application");

21 (b) A new application to re-open the record in its recent rate case (Docket No. W-
 22 01583A-04-0178) and amend Decision No. 67455 (January 4, 2005), so that the debt financing could
 23 be included in present rates for capital improvements not related to arsenic treatment (Docket No. W-
 24 01583A-05-0339);

25 (c) A new application to amend Decision No. 67455 so that the arsenic treatment costs
 26 related to the debt financing could be recovered through an Arsenic Recovery Mechanism ("ACRM")

27
 28 ¹ In its rebuttal testimony, the Company increased its cost estimates, and need for loan funds, to \$1,889,168.

1 (Docket No. W-01583A-05-0340); and

2 (d) A Motion to re-open the recent rate case (Docket No. W-01583A-04-0178).

3 5. On May 25, 2005, Commission Utilities Division Staff ("Staff") filed a Response to
4 the request to re-open Docket No. W-01583A-04-0178. Staff believed that the need for arsenic
5 treatment was an extraordinary circumstance that warranted re-opening the rate case. However,
6 Staff opposed re-opening the rate case for any other reason than to consider arsenic treatment.

7 6. On June 1, 2005, Staff filed a request to close Docket No. W-01583A-05-0339,
8 because that Docket included a request to re-open the docket for non-arsenic related issues.

9 7. On June 14, 2005, LQS filed a Motion to Amend the Finance Application. LQS
10 revised its financing request to \$1,648,750, as it had discovered that \$140,625 of its original
11 financing request was related to non-arsenic capital improvements.

12 8. On June 23, 2005, the Commission convened a Procedural Conference to consider
13 how it would proceed with the various requests before it. Staff continued to oppose re-opening the
14 rate case to consider anything other than arsenic-related expenses. Although LQS continued to
15 believe that portions of the financing request related to installing additional storage facilities should
16 be considered, it agreed to further amend its Finance Application to bifurcate the two financing
17 requests.

18 9. On July 7, 2005, LQS filed a Motion to Amend its Finance Application to remove that
19 portion of the request related to non-arsenic related capital improvements.

20 10. By Procedural Order dated July 27, 2005, the Commission: re-opened Docket No, W-
21 01583A-04-0178 pursuant to A.R.S. § 40-252; granted LQS's motion to amend its Finance
22 Application; administratively closed Docket No. W-01583A-05-0339; consolidated the three
23 remaining dockets; and established a procedural schedule for a hearing on the request for an ACRM.

24 11. By Procedural Order dated August 18, 2005, the Commission suspended the
25 procedural schedule at the request of the parties.

26 12. On November 8, 2005, the Commission granted intervention to Mr. John Gay, a
27 shareholder and customer of the Company.

28 13. On November 15, 2005, LQS and Staff jointly proposed a new procedural schedule.

1 By Procedural Order dated November 16, 2005, the Commission approved the proposed schedule
2 and set a hearing to commence on March 1, 2006.

3 14. Pursuant to the November 16, 2005 Procedural Order, LQS mailed notice of the
4 hearing on December 19, 2005 and caused the notice to be published in the *Green Valley News and*
5 *Sun* on December 21, 2005.

6 15. On December 7, 2005, LQS filed the direct testimony and exhibits of Mike Wood, a
7 Company board member; Mark Taylor, an engineer with Westland Resources, Inc.; Kimberly
8 Yaglowksi, a banker; and Ron Kozoman, an accountant.

9 16. On January 25, 2006, Staff filed the direct testimony and exhibits of Daniel Zivan and
10 Dorothy Haines.

11 17. Mr. Gay filed direct testimony on January 26, 2006.

12 18. On February 21, 2006, LQS filed the rebuttal testimony of Mike Wood, Mark Taylor
13 and Ron Kozoman.

14 19. The hearing convened before a duly authorized Administrative Law Judge on March
15 1, 2006, at the Commission's Tucson offices.

16 20. The Commission received eight written comments from customers opposed to
17 spending \$1.6 million for arsenic treatment and supporting the purportedly less expensive proposal
18 advanced by Mr. Gay. At the commencement of the hearing, one individual, a shareholder of the
19 Company, appeared to give public comment and submitted a letter on behalf of herself and her sister
20 opposing the more expensive proposal.

21 21. The parties agree that the Company must comply with the EPA arsenic regulations;
22 that the Company does not have the ability to internally finance the necessary capital improvements;
23 and there is a need for an ACRM/ARSM² to obtain funds through rates and charges to service
24 borrowing costs associated with arsenic treatment.

25 22. The parties disagree about the scope of capital improvements that are necessary for an
26 arsenic treatment system; the costs of the arsenic treatment improvements and the type of long-term
27

28 ² Arsenic Recovery Surcharge Mechanism.

1 borrowing arrangement that should be approved.

2 23. LQS proposes to construct a combined treatment system for Well Nos. 6 and 7, and a
3 separate treatment system for Well No. 5. Under the plan, a new dedicated raw water main from
4 Well No. 7 will bring raw water to the arsenic treatment plant at Well No. 6 for treatment. Both
5 Wells Nos. 6 and 7 will pump raw water through the treatment facility at Well No. 6 and a
6 combination of blended and treated water will fill a new onsite storage reservoir. A new booster
7 station will pump the treated water from the reservoir into the water system. Control of the booster
8 station will be based on the level of water in the existing highwater storage tanks. The Company
9 plans a backup generator to supply the system with treated water during emergencies. The
10 Company determined that an absorption media arsenic removal process was the best means of
11 treatment for the system, and selected Severn Trent as the vendor. Under this method, ferric oxide
12 absorption media removes arsenic from the water by absorbing arsenic onto the surface of the
13 media. The non-treated water is pumped through a pressure vessel containing the absorption media.
14 LQS's engineer consultant testified that the exhausted media can be discarded in landfills and is
15 classified as non-hazardous waste. The major capital improvements for this system are steel pressure
16 vessels and a backwash tank.

17 24. As its final position, LQS proposes to construct the following capital improvements³
18 associated with its planned arsenic treatment system:

19	Site Demolition	\$12,500
20	Site Piping Well Site No. 6	92,000
21	Concrete Slabs	18,000
22	12 inch main between Wells Nos. 6 and 7	199,125
23	250,000 gallon Storage reservoir	190,000 ⁴
24	transfer booster station	220,000
25	1,290 gpm absorption arsenic treatment system	400,000

26
27 ³ Cost estimates taken from Taylor rebuttal testimony.

28 ⁴ The Company had originally included a 400,000 gallon storage tank at an estimated cost of \$270,000, but revised its estimate downward to include a 250,000 gallon tank in response to Staff's opposition to recovering the cost of the 400,000 gallon storage tank as part of the arsenic treatment recovery mechanism.

1	backwash holding tank - Well No. 6	25,000
2	200 gpm absorption treatment system - Well No 5	150,071
3	Well No. 5 backwash tank	4,000
4	130 KW back-up generator at Well No. 6	60,000
5	Fencing Well Site No. 6	43,000
6	Well pump modifications Well Nos. 6 & 7	30,000
7	3 chlorination units	6,000
8	3 sand separators	13,827
9	3,000 gallon pressure tank Well No. 6	20,000
10	Electrical	47,800
11	Air compressor	5,000
12	Disinfection and testing	<u>5,000</u>
13	Total	1,541,323
14	Tax @ 5.59 %	86,160
15	Bond	<u>10,800</u>
16	Subtotal	1,638,313
17	15% engineering and contingencies	<u>245,747</u>
18	Total	1,884,060

19 The Company's costs are based on the estimates provided by Smyth Steel, a southern Arizona based
20 contractor.

21 25. Mr. Gay hired Miller Brooks Environmental, Inc. ("Miller Brooks"), an engineering
22 firm, to design a treatment system that would treat the arsenic at each well rather than by means of a
23 centralized system as recommended by Westland Resources. Mr. Gay asserts that his proposal
24 would have a capital cost of \$580,000. (Ex I-1, G 4). The Miller Brooks proposal utilizes the same
25 method of absorption treatment as utilized in the LQS proposal.

26 26. During the hearing, Mr. Gay testified that he believed that the best course of action for
27 LQS would be for it to be acquired by its much larger neighboring water company -- Community
28 Water Co., as the economies of scale of treating arsenic could be spread over a larger number of

1 consumers. (TR at 194). Mr. Gay introduced evidence consisting of newspaper articles that
2 mention a possible offer by Community to buy LQS.

3 27. LQS states that the Miller Brooks report presents a feasible concept for arsenic
4 treatment, but that it omits portions of the system that LQS believes are necessary such as flow
5 control, chlorination, sand separation and back-up power. LQS believes the Miller Brooks proposal
6 did not consider the water system as a whole and assumed that all of the work would be either self-
7 performed by LQS or subcontracted to local contractors. Specifically, LQS states that Miller Brooks
8 was not asked to: 1) perform site visits to confirm information or identify site-specific construction
9 factors; 2) determine if other solutions would better fit the overall LQS system; 3) analyze the
10 existing water system for deficiencies; 4) identify water system issues that could be intensified by
11 implementation of the plan; or 5) determine the effect of the proposed improvements on the existing
12 system.

13 28. LQS also argues that the Miller Brooks cost estimates do not allow for an "apples-to-
14 apples" comparison with the LQS proposal as they use different assumptions. LQS states that it
15 assumed that LQS would publicly bid the plans for the combined treatment system at Wells Nos. 6
16 and 7 due to the complexity of the system which would require a significant construction effort to
17 assemble. LQS assumed that LQS would install the small packaged system for Well No. 5. Miller
18 Brooks assumed that LQS would perform most of the construction at all three sites. In addition,
19 LQS asserts that the Miller Brooks estimate: 1) does not allow a mark-up for the labor costs for a
20 general contractor; 2) does not allow for the costs of equipment, such as cranes, that would be
21 needed to install the plant; 3) does not include shipping costs from Pittsburgh, Pennsylvania; 4) does
22 not include appropriate unit costs for short length of piping and installation in a retrofit situation
23 where hand-digging may be required; 5) does not include chlorination equipment; and 6) does not
24 include sand equipment.

25 29. LQS had Smyth Steel perform a cost estimate of the Miller Brooks proposal which
26 indicates the Miller Brooks proposal would incur construction costs of \$1,055,913, before a 15
27 percent allowance for engineering and contingencies costs. Based on the Smyth Steel analysis, LQS
28 estimates that the Miller Brooks design would have a total cost of \$1,214,000. (Ex AR-11 Taylor

1 Rebuttal at 5.)

2 30. LQS criticizes the Miller Brooks proposal because it does not achieve both of LQS's
3 goals of 1) complying with EPA standards and 2) continuing to provide adequate and reliable water
4 service to customers. While LQS acknowledges that the Miller Brooks proposal results in water that
5 complies with EPA arsenic standard, it argues that the proposal does not address factors that LQS
6 believes are integral to system reliability, namely storage, excessive pressures and well capacity.

7 31. LQS states it has received no offer of purchase from Community Water, and argues
8 that the newspaper articles are unsubstantiated hearsay.

9 32. Staff concurs that the Company's selected treatment option is appropriate for the LQS
10 system, but does not believe that all the items included in the Company's proposal for an ACRM are
11 appropriate. Staff recommends excluding the 400,000 gallon storage tank, installation of the
12 emergency backup generator, and the chlorination units. Staff's calculations show that the Company
13 has adequate storage and production capacity at this time and that the Severn Trent system does not
14 require storage capacity in its arsenic removal process. Staff states the emergency generator is not
15 required for the proper operation of the arsenic treatment system, and the Severn Trent system does
16 not require that disinfection occur before delivering treated water.

17 33. In addition, Staff recommends cost adjustments to several of the items. Staff utilized
18 statewide averages to recalculate the costs of some of the components of the treatment system.
19 Specifically, Staff estimated that rather than \$65 per foot for the 12-inch main, the cost should be
20 closer to \$36.70 per foot. Staff also believed that the cost of the backwash tanks should be reduced
21 from \$25,000 to \$13,400 for the 13,400 gallon tank at Well No. 6 and from \$4,000 to \$3,600 for the
22 3,000 gallon tank at Well No. 5. Staff further reduced the cost of the 3,000 gallon pressure tank
23 from \$18,000 to \$12,000.⁵ Consequently, Staff concluded that the Company's Arsenic Treatment
24 Project, as adjusted to reflect Staff's recommendations, is reasonable. Staff's recommended
25 adjustments to the Company's proposal are as follows:

26 Site Demolition \$ 10,000

27
28 ⁵ Staff utilized the estimates provided in the Company's direct testimony and not the revised estimates resulting from the Smyth Steel review.

1	Site Piping Well Site No. 6	100,000
2	Concrete Slabs	14,000
3	12 inch main between Wells Nos. 6 and 7	91,750
4	250,000 gallon Storage reservoir	0
5	transfer booster station	120,000
6	1,290 gpm absorption arsenic treatment system	500,000
7	backwash holding tank - Well No. 6	13,400
8	200 gpm absorption treatment system - Well No 5	104,000
9	Well No. 5 backwash tank	3,600
10	130 KW back-up generator at Well No. 6	0
11	Fencing Well Site No. 6	40,000
12	Well pump modifications Well Nos. 6 & 7	15,000
13	3 chlorination units	0
14	3 sand separators	21,000
15	3,000 gallon pressure tank Well No. 6	12,000
16	Electrical	--
17	Air compressor	--
18	Disinfection and testing	<u>--</u>
19	Subtotal	1,059,750
20	25% engineering and contingencies	<u>264,938</u>
21	Total	1,324,688

23 34. Staff did not analyze the Miller Brooks proposal in depth and believed that it was not
 24 sufficiently detailed to allow Staff to formulate an opinion whether it would be an adequate solution
 25 to the problem. (TR at 241-42).

26 35. In addition to developing alternatives for arsenic reduction in each of the three wells,
 27 LQS states it identified additional factors that it believes are integral to system reliability and
 28 operation and which could be affected by the methodology selected for arsenic treatment. The

1 factors that LQS identified are (a) adequate storage volume; (b) excessive operating pressures in the
2 water system due to small pipeline sizes; and (c) the effect of increased pressure losses through the
3 arsenic treatment system on wellhead pressure and well capacity.

4 36. The Company argues that additional storage should be included for recovery as part
5 of the ACRM because it provides operational reliability and serves as a finished water holding tank
6 for the combined arsenic treatment product for Wells Nos. 6 and 7. Under this system, the pump
7 system will be able to deliver potable water into the system at a rate commensurate with the rate at
8 which it is being used by the system, which would reduce system operating pressures. (Ex AR-1,
9 Taylor Rebuttal at 8)

10 37. The Company argues the backup generator is necessary to the effective operation of
11 the arsenic treatment facilities as it would provide a method of accessing the treated water during a
12 power outage. LQS estimates that the Company's current storage capacity of 90,000 gallons would
13 provide only two hours of water supply if an outage occurred during peak hour demand and the
14 tanks were full.

15 38. LQS argued that the hypochlorite chlorination units not only disinfect the water, but
16 perform a specific benefit to arsenic treatment. Chlorination prior to arsenic treatment oxidizes the
17 arsenic compounds from As (III) to As (V), which is the form of arsenic most readily absorbed in
18 the absorption process.

19 39. Furthermore, the Company argues the Smyth Steel estimates are more accurate
20 estimates of the actual costs of the system than the statewide averages utilized by Staff.

21 40. We agree with Staff that only investment needed for the treatment of arsenic should be
22 included in the ACRM. In this case, we find that the storage tank and back-up generator are not
23 related to the treatment of arsenic, but that the chlorinator units, which are recommended by the
24 manufacturer and assist in the treatment process, are appropriately included. We find further, that
25 the Smyth Steel cost estimates are the best estimates of actual project costs, and use these estimates
26 to determine the cost of the arsenic treatment plant for purposes of evaluating the amount of
27 financing authority to approve and the calculation of the ACRM.

28 41. In removing the additional storage and back-up generator from the treatment facilities

1 included in the ACRM, we are not making a finding that these investments would not be prudent.
 2 In weighing all the evidence, however, we find that the storage tank and back-up generator
 3 components of the Company's proposal are related to overall system reliability rather than to arsenic
 4 treatment, and as such are not properly included in the ACRM.

5 42. Based on the best available information, we approve financing authority for the
 6 installation of arsenic treatment facilities in an amount up to \$1,580,446, determined as follows:

7	Company estimate	\$ 1,541,323
8	Less Storage	(190,000)
9	Less generator	(60,000)
10	Subtotal	1,291,323
11	Tax at 5.59%	72,185
12	Bond	10,800
13		1,374,308
14	15 % contingency	206,146
15	Total	1,580,446

16 43. Recovering costs by means of a surcharge does not provide an incentive for any
 17 Company to keep costs low. The Company indicated that it would place the project out for bid, and
 18 we expect the Company to use its best efforts to keep costs of the project as low as possible while
 19 still constructing an effective treatment plant. Because we do not include additional storage in the
 20 ACRM, the Company will need to determine whether it will install the storage it has proposed. In
 21 the event the Company elects not to install the additional storage it proposed in this proceeding,
 22 there would be no advantage to transporting the water from Well No. 7 to Well No. 6 for treatment,
 23 and consequently treating the arsenic at each wellhead would be the lower cost option.⁶ The
 24 Company has estimated that the cost of the Miller Brooks proposal for treating the water at each
 wellhead would be \$1,214,000. Additionally, under either option, if actual costs of construction are
 lower than the financing authority granted herein, the ACRM surcharge should be reduced to reflect
 actual financing costs rather than the face amount of the loan.

25 44. LQS testified that following Commission approval of this request, it will take eight
 26

27 ⁶ There is an advantage of holding the treated water in storage, as it would decrease pressures on the wellheads from
 28 arsenic treatment and thus reduce wear on the pumps and extend equipment life. We do not find that this advantage is
 sufficient to include the cost of additional storage in the ACRM, but will include the capital costs associated with
 transporting the water for treatment as proposed.

1 months to complete the installation of the arsenic treatment facilities. LQS is required to meet
2 compliance with the arsenic MCLs in the first quarter of 2007. (TR at 132-133). The Company must
3 take action to treat its arsenic as soon as possible.

4 45. We find that there is no reliable evidence that Community Water has, or will, make a
5 bid to purchase LQS within a timeframe that would allow LQS to meet its obligation to treat its
6 water for arsenic.

7 46. LQS proposes to borrow the funds necessary to finance the acquisition and installation
8 of the arsenic treatment facilities from the Arizona Water Infrastructure Authority ("WIFA"), or
9 from Commerce Bank of Arizona ("Commerce Bank").

10 47. LQS originally proposed to obtain a loan from WIFA, and that in the event WIFA
11 could not, or would not, approve the loan request in time for LQS to commence construction of the
12 planned facilities, LQS was seeking authority to borrow the funds from Commerce Bank. During
13 the course of the proceeding, however, it became less clear that the Company was advocating the
14 WIFA loan as its preferred choice. Although the WIFA loan would likely have a lower monthly
15 payment, the shorter term of the Commerce Bank loan (10 years versus 20 years for the WIFA loan),
16 means that over the life of the loan, the Company, and ultimately ratepayers, would pay less with the
17 bank loan. The Company is ambivalent and leaves to the Commission to determine which financing
18 option should be approved.

19 48. The Company currently has a capital structure consisting of 100 percent equity.
20 Borrowing \$1,580,446, would result in a capital structure composed of 80.6 percent debt and 19.4
21 percent equity.

22 49. A WIFA loan is expected to have a term of 20 years and an estimated interest rate of
23 7.6 percent annually (80 % of prime plus 2%).⁷ Borrowing \$1,580,446 from WIFA on these terms,
24 would result in a monthly payment of \$12,829. There is no origination fee associated with the
25 WIFA loan, but WIFA would require that the Company maintain a loan reserve equal to 20 percent
26

27
28 ⁷ For purposes of this proceeding, the parties assume that the WIFA subsidy would be 20 percent, however, WIFA may
approve a greater subsidy of 25 or 30 percent.

1 of the principal.⁸

2 50. A loan from Commerce Bank would have a term of 10 years and an interest rate of 8
3 percent annually. Borrowing \$1,580,446 from Commerce Bank on these terms would result in a
4 monthly payment of \$19,175. The Commerce Bank loan requires closing costs of \$12,153 (.75% x
5 loan amount + \$300).

6 51. Staff recommended that the Commission authorize LQS to borrow \$1,324,688 from
7 WIFA and did not recommend approval of the loan from Commerce Bank. Staff believed that the
8 lower monthly debt cost associated with the proposed WIFA loan made it the more attractive
9 alternative. Staff states that WIFA has never denied a loan request such as this and Staff did not
10 believe the Company required authority to borrow from Commerce Bank as a back-up position. (TR
11 at 253).

12 52. Staff concluded that authorizing the WIFA debt would be lawful and within the
13 corporate powers of LQS, compatible with the public interest, consistent with sound financial
14 practices, and would not impair LQS's ability to provide service if an arsenic removal surcharge
15 mechanism is adopted.

16 53. The parties do not dispute the formula for determining the ACRM. A copy of Staff's
17 proposed methodology for calculating the ACRM is attached hereto as Exhibit A.

18 54. Assuming a WIFA loan of \$1,580,446 at 7.6 percent interest for 20 years and utilizing
19 the methodology of calculating the ACRM as set forth in Exhibit A, the ACRM for the 5/8 inch
20 meter would be approximately \$13.99 per month.⁹

21 55. Assuming a Commerce Bank loan of \$1,580,446 at 8 percent for 10 years, and
22 utilizing the methodology of calculating the ACRM as set forth in Exhibit A, the ACRM for the 5/8
23 inch meter would be approximately \$22.27 per month.

24 ⁸ A 20 percent loan reserve would be \$316,089, which would require a \$5,268 deposit each month for the first five years
25 of the loan.

26 ⁹ This ACRM calculation is provided as a means to compare the effect of the two loan proposals. The calculations set
27 forth herein utilize Staff's methodology, but employ the equivalent bill count that includes standpipe customers as set
28 forth in the rebuttal testimony of Ron Kozoman (Ex AR-9). The parties utilized different equivalent bill counts, possibly
because they used customer counts at different points in time. (TR 276) Staff agrees that all customers, including
standpipe customers should be included in the determining the surcharge amount. Testimony indicates that a new
subdivision is currently under development which has the potential of adding 234 additional residential units. (TR at 72).

1 56. We are concerned with the impact of the surcharge on ratepayers. Thus, we authorize
2 the Company to borrow up to \$1,580,446 from WIFA for the purpose of acquiring and installing
3 arsenic treatment facilities. The monthly loan service payments associated with the WIFA loan are
4 substantially lower, and will result in a lower monthly surcharge, than those of the Commerce Bank
5 loan. In the event WIFA does not approve the loan request through no fault of the Company, LQS
6 shall notify the Commission and requires this matter be reconsidered for the sole purpose of
7 addressing the financing authority. The Commission will consider such request as expeditiously as
8 possible.

9 57. Staff further recommends:

10 (a) authorizing an arsenic removal surcharge mechanism in order to provide LQS
11 with a mechanism for applying for a surcharge to meet debt service requirements associated with the
12 proposed financing;

13 (b) That LQS file the arsenic surcharge filing within 15 days of the loan closing;

14 (c) That LQS be required to calculate its proposed surcharge tariff using the actual
15 loan principal and interest components and the same methodology that Staff used to determine the
16 estimated surcharge amount in its testimony in this proceeding;

17 (d) That the Company engage in any transactions and to execute any documents
18 necessary to effectuate the authorizations granted; and

19 (e) That the Commission deny the Company's request to recover \$21,000 in annual
20 operations and maintenance expense.

21 58. Our approval of the ACRM process, as outlined in this Order, recognizes that LQS
22 faces significant costs in the next several years to comply with the EPA's new arsenic MCL
23 standards. The impact on LQS, will be significant. Absent the implementation of an ACRM, the
24 only viable alternative would be a series of rate applications and the possibility that interim rate
25 relief would be required to maintain the Company's financial integrity until rate relief could be
26 granted.

27 59. In order to insure the appropriate application of the ACRM, upon completion of the
28 project, the Company should file as a compliance item in this docket, complete documentation of

1 actual costs for the construction of the arsenic treatment facilities approved herein. Staff shall
2 review the documentation and determine whether the actual costs warrant a reduction in the ACRM
3 surcharge.

4 CONCLUSIONS OF LAW

5 1. LQS is a public service corporation within the meaning of Article XV of the Arizona
6 Constitution and A.R.S. §§40-250 and 40-251.

7 2. The Commission has jurisdiction over LQS and of the subject matter of the issues
8 raised in the Company's request for an ACRM.

9 3. Notice of the application was provided in the manner prescribed by law.

10 4. Approval of the ACRM, as set forth herein, is consistent with the Commission's
11 authority under the Arizona Constitution, ratemaking statutes, and applicable case law.

12 5. Approval to borrow up to \$1,580,446 from WIFA for the purpose of financing arsenic
13 treatment facilities, is compatible with the public interest, with sound financial practices, and with
14 the proper performance by LQS of service as a public service corporation.

15 6. Staff's recommendations set forth in Findings of Fact No. 57 are reasonable and
16 should be adopted, and approval of the ACRM is specifically conditioned on compliance with these
17 Staff recommendations.

18 ORDER

19 IT IS THEREFORE ORDERED that Las Quintas Serenas Water Company's application for
20 an Arsenic Cost Recovery Mechanism is approved, to the extent described herein.

21 IT IS FURTHER ORDERED that Las Quintas Serenas Water Company shall, in conformance
22 with Staff's recommendations, make an arsenic surcharge recovery filing within 15 days of the loan
23 closing.

24 IT IS FURTHER ORDERED that Las Quintas Serenas Water Company shall calculate its
25 proposed surcharge tariff using the actual loan principal and interest components and the
26 methodology set forth in Exhibit A.

27 IT IS FURTHER ORDERED that Las Quintas Serenas Water Company is authorized to
28 borrow up to \$1,580,446 from the Arizona Water Infrastructure Finance Authority for a term of 20

1 years at the then prevailing interest rate.

2 IT IS FURTHER ORDERED that the finance authority granted herein shall be expressly
3 contingent upon Las Quintas Serenas Water Company's use of the proceeds for the purposes stated in
4 its Application.

5 IT IS FURTHER ORDERED that Las Quintas Serenas Water Company is authorized to
6 execute any documents necessary to effectuate the authorization granted.

7 IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not
8 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
9 proceeds derived thereby for purposes of establishing just and reasonable rates.

10 IT IS FURTHER ORDERED that Las Quintas Serenas Water Company shall use its best
11 efforts to keep the costs of its arsenic treatment plant as low as reasonably possible and shall file with
12 Docket Control, as a compliance item in this docket, complete documentation of the actual costs of
13 the acquisition and installation of the arsenic treatment facilities approved herein. Staff shall review
14 the documentation and determine whether actual costs are lower than the approved loan amount and
15 warrant a reduction in the ACRM surcharge.

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1 IT IS FURTHER ORDERED that operating expenses associated with the arsenic treatment
2 system approved herein shall not be recovered as part of the ACRM.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
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7

8 CHAIRMAN

COMMISSIONER

11
12 COMMISSIONER

COMMISSIONER

COMMISSIONER

13
14 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
15 Director of the Arizona Corporation Commission, have
16 hereunto set my hand and caused the official seal of the
Commission to be affixed at the Capitol, in the City of Phoenix,
this ____ day of _____, 2006.

17
18 BRIAN C. McNEIL
EXECUTIVE DIRECTOR

19
20 DISSENT _____

21
22 DISSENT _____

23 JR:mj
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1 SERVICE LIST FOR:

LAS QUNITAS SERENAS WATER COMPANY

2 DOCKET NO.:

DOCKET NO. W-01583A-04-0178

DOCKET NO. W-01583A-05-0236

DOCKET NO. W-01583A-05-0340

4

5 Mr. Steve Gay
6 General Manager/Operator
7 Las Quintas Serenas Water Company
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16 Utilities Division
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Las Quintas Serenas Water Co.
 Docket No. W-01583A-05-0326 and W-01583A-05-0340
 Application for Financing

Instructions to Calculate the Annual Surcharge Revenue Requirement on the Loan

Step 1. Find the Annual Payment on the Loan

Refer to Table A, the Conversion Factor Table. Reading the table from top to bottom, find the interest rate in column A that is equal to the stated annual interest rate of the loan. Reading across the table, find the Annual Payment Conversion Factor in Column B that corresponds with the loan interest rate (in the event that the loan interest rate is different from the interest rates in Table A, use the next higher interest rate that can be found in Table A). Multiply that annual payment conversion factor by the total amount of the loan to calculate the annual debt service on the loan.

Annual payment conversion factor
 (*) Times total amount of the loan
 (=) Equals annual debt service on the loan

Step 2. Find the Annual Interest Payment on the Loan

Refer to Table A and find the annual interest payment conversion factor in Column C that corresponds with the stated annual interest rate of the loan. Multiply the annual interest payment conversion factor by the total amount of the loan to calculate the annual interest expense on the loan.

Annual interest payment conversion factor
 (*) Times total amount of the loan
 (=) Equals annual interest expense on the loan

Step 3. Find the Annual Principal Payment on the Loan

Refer to Table A and find the annual principal payment conversion factor in Column D that corresponds with the stated annual interest rate of the loan. Multiply the annual principal payment conversion factor by the total amount of the loan to calculate the annual principal payment on the loan.

Annual principal payment conversion factor
 (*) Times total amount of the loan
 (=) Equals annual principal payment on the loan

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 Application for Financing

Step 4. Find the Gross Revenue Conversion Factor¹ (GRCF)

The GRCF calculated below is used in step 5.

$$\text{GRCF} = \frac{1}{1 - \text{Effective incremental income tax rate}^2}$$

$$\text{GRCF} = \frac{1}{1 - 0.2918} = \frac{1}{0.7082} = 1.4120$$

Step 5. Find the Incremental Income Tax Factor

The incremental income tax factor is calculated below:

$$\begin{aligned} \text{Incremental Income Tax Factor} &= \text{GRCF} - 1 \\ &= 1.4120 - 1 \\ &= 0.4120 \end{aligned}$$

Step 6. Find the Annual Income Tax Component of the Surcharge Revenue

Multiply the incremental income tax factor by the annual principal payment on the loan determined in step 3 to calculate the income tax component of the annual surcharge revenue.

Incremental income tax conversion factor

(*) Times the annual principal payment on the loan

(=) Equals the annual income tax component of the annual surcharge revenue

Step 7. Find the Debt Service Component of the Annual Surcharge Revenue

Add the annual interest expense on the loan determined in step 2 to the annual principal payment determined in step 3. The sum is the debt service component of the annual surcharge revenue.

Annual interest payment on the loan

(+) Plus annual principal payment

(=) Equals the debt service component of the annual surcharge revenue

¹ The gross revenue conversion factor indicates the incremental revenue required to increase operating income by one dollar.

² The effective income tax rate represents the effective tax rate on the incremental income. Use the effective incremental income tax rate of 29.1762%.

Las Quintas Serenas Water Co.

Docket No. W-01583A-05-0326 and W-01583A-05-0340

Application for Financing

Step 8. Find the Total Annual Surcharge Revenue Requirement Needed for the Loan.

Add the annual income tax component determined in step 6 to the annual debt service component determined in step 7. The sum equals the annual surcharge revenue requirement for the loan.

Annual income tax component of the surcharge revenue

(+) Plus annual debt service component of the surcharge revenue

(=) Equals the total annual surcharge revenue requirement for the loan

Instruction for Step 9**Step 9. Find the equivalent bills.**

Multiply the NARUC meter capacity multiplier by the number of current customers and by the number of months per year. The sum of the products equals the equivalent bills.

Result

Col A	Col B	Col C	Col D	Col E
Meter Size	NARUC Meter Capacity Multiplier	Number of Customers	Number of Months In Year	Equivalent Bills Col B x C x D
5/8" x 3/4" Meter	1	0	12	0
3/4" Meter	1.5	0	12	0
1" Meter	2.5	0	12	0
1½" Meter	5	0	12	0
2" Meter	8	0	12	0
3" Meter	15	0	12	0
4" Meter	25	0	12	0
6" Meter	50	0	12	0
			Total	0

Instruction for Step 10**Step 10. Find the monthly surcharge for 5/8" x 3/4" customers.**

Divide the result obtained in step 8 by the number of equivalent bills calculated in step 9 to obtain the monthly surcharge for 5/8" x 3/4" customers.

Result

\$140,300	Total annual surcharge revenue requirement for the loan (Step 8)
÷ 10,920	Number of equivalent bills
\$ 12.85	Total monthly surcharge for 5/8" x 3/4" customers

Las Quintas Serenas Water Co.

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Application for Financing

Instruction for Step 11

Step 11. Find the monthly surcharge for remaining meter size customers.

Multiply the Result obtained in step 10 by the NARUC meter capacity multipliers to obtain the monthly surcharges for all other meter sizes.

Col A	Col B	Col C	Col D
Meter Size	NARUC Meter Capacity Multiplier	5/8" x 3/4" Customers' Surcharge	Surcharge by Meter Size Col B x C
5/8"x 3/4" Meter	1	\$0.00	\$ 0.00
3/4" Meter	1.5	\$0.00	\$ 0.00
1" Meter	2.5	\$0.00	\$ 0.00
1½" Meter	5	\$0.00	\$ 0.00
2" Meter	8	\$0.00	\$ 0.00
3" Meter	15	\$0.00	\$ 0.00
4" Meter	25	\$0.00	\$ 0.00
6" Meter	50	\$0.00	\$ 0.00

Las Quintas Serenas Water Company
 Docket No.'s W-01583A-05-0326 and W-01583A-05-0340
 Test Year Ended September 30, 2003

Schedule DTZ-3

TABLE A
 Conversion Factor Table (Based on a 20-year Loan)

Line Item	Interest Rate	Factor 1	Factor 2	Factor 3
1	3.50%	0.0696	0.0344	0.0352
2	3.75%	0.0711	0.0369	0.0342
3	4.00%	0.0727	0.0394	0.0333
4	4.25%	0.0743	0.0419	0.0324
5	4.50%	0.0759	0.0444	0.0316
6	4.75%	0.0775	0.0468	0.0307
7	5.00%	0.0792	0.0493	0.0299
8	5.25%	0.0809	0.0518	0.0291
9	5.50%	0.0825	0.0543	0.0283
10	5.75%	0.0843	0.0568	0.0275
11	6.00%	0.0860	0.0593	0.0267
12	6.25%	0.0877	0.0618	0.0259
13	6.50%	0.0895	0.0643	0.0252
14	6.75%	0.0912	0.0668	0.0245
15	7.00%	0.0930	0.0692	0.0238
16	7.25%	0.0948	0.0717	0.0231
17	7.50%	0.0967	0.0742	0.0224
18	7.75%	0.0985	0.0767	0.0218
19	8.00%	0.1004	0.0792	0.0211